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SUBMITTED ELECTRONICALLY

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Re: Savings and Loan Holding Companies: Regulation LL; Docket No. R-1429; RIN No. 7100 AD-80

Dear Ms. Johnson:

We appreciate the opportunity to comment on the interim final rule published by the Board of Governors of the Federal Reserve System ("Board") regarding the regulation of savings and loan holding companies ("SLHCs"). We represent various entities that have invested in SLHCs.

New Regulation LL generally applies the Board's established control rules and processes to SLHCs, thereby replacing the control rules of the Office of Thrift Supervision ("OTS") that had applied to thrifts and their holding companies since 1985. In light of the similarities between the statutes governing bank holding companies ("BHCs") and SLHCs, the Board explains in the preamble that having a single set of rules and processes with respect to control determinations involving BHCs and SLHCs will ensure consistency between equivalent statutes administered by the same agency.

However, in crafting Regulation LL, the Board failed to include an exemption for customary one-time proxy solicitations in Subpart B of Regulation LL regarding the acquisition of control of savings associations. While a proxy solicitation exemption is included in Subpart D implementing the Change in Bank Control Act ("CIBCA"), the omission of a comparable exemption in Subpart B may impact the ability of investors to solicit revocable proxies solely for the conduct of business at an annual or special meeting of shareholders, which has long been recognized as a permissible expression of shareholder democracy. The omission of a proxy solicitation exemption from Subpart B

would not only represent a sharp departure from the longstanding control rules of the OTS, it would also result in differing control rules applying to BHCs and SLHCs without any apparent policy reason for such distinction.

The Proxy Solicitation Exemption under the Prior OTS Rules

In 1985, the OTS adopted a single set of control rules implementing the Home Owners' Loan Act ("HOLA") and the CIBCA. Under those rules, an acquirer was determined, subject to rebuttal, to have acquired control of a savings association or an SLHC if the acquirer, directly or indirectly, held any combination of voting stock and revocable and/or irrevocable proxies, representing more than 25% of any class of voting stock of the institution, provided that the holding of proxies would only be counted towards the 25% threshold if they would enable the acquirer to (i) elect one-third or more of the institution's board of directors, (ii) cause the institution's stockholders to approve the acquisition or corporate reorganization of the institution or (iii) exert a continuing influence on a material aspect of the business operations of the institution.[1]

In other words, the holding of proxies would not be counted towards the 25% voting threshold if they would enable an investor to take any other actions, such as electing *less than* 1/3 of the board. In crafting this provision, the Federal Home Loan Bank Board (the predecessor to the OTS) ("FHLBB") struck a balance between addressing legitimate control concerns without unduly restricting the processes of shareholder democracy. As stated in the preamble to the 1985 rule:

> The [FHLBB] notes that the literal language of both the Holding Company Act and the Control Act covers the holding of proxies representing 25% or more of an insured institution's voting stock, regardless of the purposes of the proxy. Rather than apply the statutes in so broad a manner, however, the [FHLBB] has elected to treat the holding of revocable proxies representing more than 25% of a class of voting stock as giving rise to a rebuttable determination of control, *and only so when the proxies relate to specified matters that are indicative of the proxy holder's ability to acquire and exercise effective control on a continuing basis.* In so doing, the [FHLBB] has sought not to unduly interfere in the corporate

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[1] 12 C.F.R. § 574.4(b)(2).

> governance procedures of insured institutions, while at the same time protecting the [FHLBB's] interest in scrutinizing changes [in] control before, rather than after, they occur.[2]

The OTS rules correctly recognized that not all proxy solicitations raise control issues under the HOLA and the CIBCA. Similarly, as discussed below, the Board's Regulation Y provides that voting rights acquired for the sole purpose of participating in a proxy solicitation will not result in the formation of a BHC or result in a change in control under the CIBCA. However, as currently drafted, Regulation LL could limit an investor's ability to conduct *any* proxy solicitation, even one that would clearly not raise control issues under the HOLA.

The Proxy Solicitation Exemptions under Regulation Y

The Board has long recognized that minority shareholders of a BHC may conduct a one-time proxy solicitation to conduct business at an annual or special meeting without implicating the bank control rules.

Regulation Y excludes from the definition of BHC any company whose direct or indirect control over a bank results from the ownership or control of "voting rights to voting securities acquired for the sole purpose and in the course of participating in a proxy solicitation, as provided in Section 2(a)(5)(C) of the [Bank Holding Company] Act."[3] That section of the Bank Holding Company Act ("BHCA") exempts any "company formed for the sole purpose of participating in a proxy solicitation" from being a BHC "by virtue of its control of voting rights of shares acquired in the course of such solicitation."[4] Additionally, Regulation Y exempts from the prior notice requirements of the CIBCA any "acquisition of the power to vote securities of a . . . [BHC] through receipt of a revocable proxy in connection with a proxy solicitation for the purposes of

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2 Acquisitions of Control of Insured Institutions, 50 Fed. Reg. 48686, 48698 (Nov. 26, 1985) (emphasis added) (citation omitted).

3 12 C.F.R. § 225.2(c)(1)(iii).

4 12 U.S.C. § 1841(a)(5)(C).

conducting business at a regular or special meeting of the institution, if the proxy terminates within a reasonable period after the meeting."[5]

The Board has issued several opinions concluding that shareholders need not obtain prior regulatory approval in connection with the solicitation of proxies to remove management or elect a slate of directors in opposition to management.[6] This position was reiterated by the Board in its 1997 amendments to Regulation Y.[7] Moreover, over the years, there have been numerous proxy contests by individuals and companies that held 9.9% or less of a BHC seeking to elect a slate of directors to the board, without any suggestion that such proxy contests required prior approval of the Board. The Board has also determined that the solicitation of proxies by a shareholder for the purpose of opposing a bank merger did not result in a violation of control rules based on the proxy solicitation exemption in 225.2(c)(1)(iii) of Regulation Y.[8]

These precedents underscore the fact that the proxy solicitation process – which enables all of the shareholders of a company to decide among competing proposals – is a

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5 12 C.F.R. § 225.42(a)(5).

6 *See* 1995 Fed. Res. Interp. Ltr. LEXIS 160 (Mar. 6, 1995) (stating that the Board has recognized as a matter of policy that shareholders may exercise control outside of the CIBCA's requirements by soliciting proxies for the purpose of removing existing management at an annual meeting); 1991 Fed. Res. Interp. Ltr. LEXIS 40 (May 21, 1991) (no prior notice required under CIBCA where shareholders solicited proxies to expand a company's board and elect a majority of directors); 1979 Fed. Res. Interp. Ltr. LEXIS 103 (Mar. 23, 1979) (confirming the Board's position that the solicitation of revocable proxies does not require notice under the CIBCA).

7 *See* 1997 Fed. Res. Interp. Ltr. LEXIS 223 (Feb. 12, 1997) (stating that "[t]he Board has long held . . . that the [CIBCA] is not automatically triggered by the formation of a group for the purpose of acquiring proxies for voting shares" and that it "is not intended to be a mechanism for private parties to frustrate contested acquisitions").

8 *See* Fed. Reserve Sys., North Fork Bancorporation, Inc., Melville, New York, Order Approving the Acquisition of a Savings Association 1 n.2 (Sept. 2000), *available at* http://www.federalreserve.gov/boarddocs/press/bhc/2000/200009272/attachment.pdf.

legitimate expression of shareholder democracy for which an exemption from the control rules under the BHCA and the CIBCA is appropriate.[9]

Regulation LL Does Not Fully Incorporate a Proxy Solicitation Exemption with Respect to SLHCs

The structure of Regulation LL closely follows that of Regulation Y, with separate Subparts implementing the HOLA and the CIBCA.

Subpart D of Regulation LL implements the CIBCA and includes the same proxy solicitation exemption from the prior notice requirements that is included in Subpart E of Regulation Y with respect to BHCs.

However, with respect to the definition of an SLHC, Regulation LL does not exclude companies that acquire control of shares solely through a one-time proxy solicitation, as Regulation Y does with respect to the definition of a BHC. Nor does Regulation LL incorporate a proxy solicitation exemption in Subpart B governing the acquisition of savings associations and the formation of SLHCs. As a result, a company that solicits revocable proxies solely in connection with an annual or special meeting of an SLHC may be deemed to be an SLHC itself if it obtains proxies to vote more than 25% of the voting stock of the SLHC, which the company surely would need to do to be successful in the proxy contest.[10] This could have a chilling effect on the ability of a

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[9] The fact that the Board's standard passivity commitments include a provision prohibiting the solicitation of proxies does not suggest that the solicitation of proxies should trigger a control determination for all investors. Passivity commitments are utilized by the Board in particular cases to ensure that an investor would not have the ability to exercise a controlling influence over an institution. The fact that certain investors may provide these commitments to avoid a controlling influence determination in view of the facts at hand in a particular case, does not and should not mean that proxy solicitations are off limits to all investors, regardless of the circumstances. Indeed, such a conclusion would be inconsistent with the BHCA and prior Board precedent discussed above.

[10] An SLHC is any company that, directly or indirectly, "controls" a savings association. 12 C.F.R. § 238.2(m). A company is deemed to control a savings association or SLHC if the company, directly or indirectly, owns, controls or holds with power to vote, *or holds proxies representing*, more than 25% of the voting shares of the savings association or SLHC. 12 C.F.R. § 238.2(e)(1)-(2).

company to conduct a proxy contest with respect to an SLHC, even if the proxy contest could in no way be construed as providing the investor with the ability to exercise a controlling influence over the institution (such as a proxy contest to eliminate a staggered board or director residency requirements or to elect or remove a minority of directors).

The ability to control the election of a majority of a company's directors is one prong of the definition of control in the HOLA.[11] Thus, a proxy solicitation for *less than* a majority of the board logically should not be deemed to provide an investor with the ability to control or exercise a controlling influence over the company. Moreover, in a proxy solicitation, it is all of the shareholders of a company – not the person soliciting the proxies – who control the outcome of an election. The sponsoring shareholder only has the ability to vote its own shares at the meeting.

Unless a proxy solicitation exemption is added to the SLHC provisions of Regulation LL, an investor in banks and thrifts arguably would be able to solicit proxies with respect to an annual or special meeting of a BHC, but precluded from doing so with respect to an SLHC. This would be an illogical result and we can think of no policy reason to distinguish between BHCs and SLHCs in this respect. Moreover, by limiting shareholder rights on the SLHC side, Regulation LL could have the unintended effect of making an SLHC franchise less desirable to investors than a BHC franchise, a result that could not have been intended by Congress when it transferred authority over SLHCs to the Board pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The Board Has Authority to Exempt Persons that Conduct a One-Time Proxy Solicitation from Becoming an SLHC

We are aware that a proxy solicitation exemption is included in the BHCA but is not included in the HOLA, which raises the question of the Board's authority to include a proxy solicitation exemption in Regulation LL with respect to the SLHC provisions. However, this argument is not persuasive for several reasons. First, the Board has broad authority to adopt regulations to implement the HOLA and carry out its purposes and

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[11] 12 U.S.C. § 1467a(a)(2).

intent.[12] Moreover, it has long been held that "substantial deference is accorded to the interpretation of the authorizing statute by the agency authorized with administering it."[13]

Second, the Board, together with the Comptroller of the Currency and the Federal Deposit Insurance Corporation, included a proxy solicitation exemption in their respective regulations implementing the CIBCA shortly after adoption of the statute in 1978, even though no such exemption is included in the CIBCA.[14] Thus, the Board and the other regulators clearly determined at the time that they had the authority to include such an exemption in their regulations to avoid an illogical result under the CIBCA that Congress could not have intended. There is no reason the Board cannot similarly interpret the HOLA to exempt customary one-time proxy solicitations from triggering the formation of an SLHC, which would also lead to an illogical result given the very brief period of time that proxies are held by an investor in connection with a shareholder meeting.

Finally, as noted above, the FHLBB previously determined to exempt certain proxy solicitations from triggering a rebuttal of control determination, notwithstanding the broad "holding of proxies" language in the HOLA. The FHLBB declined to adopt an overly literal reading of the statute, which effectively would have precluded all proxy solicitations, even those that would not provide the holder with any ability to exercise effective control over the institution. Those regulations were in effect for more than 25 years and we are not aware that they were ever challenged as exceeding the scope of the FHLBB's or the OTS's authority under the HOLA. We believe the Board should take this history into account when determining the scope of its own authority under the HOLA to add a proxy solicitation exemption to the holding company provisions of Regulation LL.

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12 *See* 12 U.S.C. § 1467a(g)(1) (providing authority to "issue such regulations and orders as . . . deem[ed] necessary or appropriate to . . . administer and carry out the purposes of this section, and to require compliance therewith and prevent evasions thereof").

13 Rust v. Sullivan, 500 U.S. 173, 184 (1991) (citing Chevron U.S.A., Inc. v. Natural Res. Def. Council, 467 U.S. 837, 844 (1984)).

14 *See, e.g.,* Change in Bank Control, 44 Fed. Reg. 7120 (Feb. 6, 1979).

Conclusion

For the reasons discussed herein, the Board should amend Regulation LL to add a proxy solicitation exemption to the holding company provisions of the rule. Such an exemption already exists in Regulation Y with respect to BHCs. The exemption could be incorporated into the definition of an SLHC or added to the exemptions listed in 12 C.F.R. § 238.12 of Subpart B of the rule.

We would be pleased to discuss these issues with you at your convenience.

Sincerely,

David L. Ansell